WITNESS STATEMENT OF
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HOUSE COMMITTEE ON SMALL BUSINESS

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Chairwoman Velazquez, Ranking Member Chabot, and distinguished members of the Committee, thank you for the opportunity to appear today and outline the U.S. textile industry's perspective on the state of small business exports.

My name is Cass Johnson and I am President of the National Council of Textile Organizations (NCTO). NCTO is a not-for-profit trade association established to represent the entire spectrum of the United States textile sector, from fibers to yarns to fabrics to finished products, as well as suppliers in the textile machinery, chemical and other such sectors which have a stake in the prosperity and survival of the U.S. textile sector. NCTO is headquartered in Washington, D.C., and also maintains an office in Gastonia, North Carolina.

The U.S. textile industry is comprised almost entirely of small- and medium-sized businesses and most of the products produced by NCTO's member companies are exported overseas, so we are very appreciative that the Committee is addressing the vital issue of the barriers to exporting that small- and medium-sized businesses face.

As a sector, the U.S. textile industry is one of this nation's most successful exporters. At $16 billion last year, we are the third largest exporter of textile products in the world and export about one out of every three textile products we produce. On the apparel component side of the equation, our export percentage is even higher, with probably nine out of ten yards of U.S. fabric manufactured for use in apparel being exported overseas.

If we drill down into these numbers still further, we can see why this hearing is so important. Almost three quarters or $12 billion of all U.S. textile exports go to countries in the Western Hemisphere where free trade agreements or preference programs provide duty-free access to the U.S. market and where these countries have established assembly platforms for shipping finished garments back to the United States. Only one quarter, or $4 billion, in U.S. textile exports go to the rest of the world. This includes Europe, Japan, India, China and Brazil.

In fact, we send China, a country with a population of more than 1.4 billion people and which consumes more textile and apparel products than any other country by far and which also has a textile and apparel complex employing 15 million people, only $500 million a year in U.S. textile products. Compared to India, however, our export figures to China appear strong. India, a country with 1.1 billion people, only imports $55 million a year in U.S. textile products. We export more textile products to the United Arab Emirates annually than we do to India.

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Something is clearly not right here. While we do not expect that our textile and apparel trade with India or China should necessarily be balanced, particularly because of the high labor content in apparel, we do expect we should be able to take advantage of countries which have rapidly growing economies, large increases in per capita income, and dramatic increases in consumption of textile products. And yet that is not happening to any significant degree.

What is happening? In addition to the problem of high duties[1], we see three major non-market barriers at work. These are all imposed by foreign governments to both protect their domestic markets from import penetration and to encourage growth in their exports, and they are all costing us valuable export opportunities and that means U.S. jobs.

These three barriers are the VAT, currency manipulation and other government subsidies. Each one is significant in its own right – the combination of all three makes these large and growing markets virtually impenetrable. And the problem is not just limited to China and India though these countries represent the biggest lost opportunities. The problem extends to Brazil, Indonesia, Korea, Taiwan and, in an important degree, to the European Union.

VALUE ADDED TAX

Of these three, perhaps the most unacknowledged and least understood is the VAT or Value-Added Tax. The VAT is a tax, which averages 15 percent, that is leveled on exports from the United States (as well as other countries) to countries with a VAT system. Because virtually every country in the world has adopted a VAT (148 countries) over the last four decades, this means that virtually every product we export gets hit by the VAT.

The problem with the VAT is that U.S. exports are essentially taxed twice – first U.S. exporters pay direct taxes at home and then they pay an average 15 percent VAT assessment when those goods enter another country. The opposite is the case for products being exported to the United States. First, countries that employ a VAT, rebate the VAT when goods produced in that country are exported and then they are not required to pay a VAT or border tax when those goods are imported into the United States. This means that U.S. exports are taxed twice while imports into this country are free of most taxes incurred by U.S. producers.

Under normal WTO rules, the VAT would be considered an export subsidy and therefore be banned. WTO rules say that countries are not allowed to provide export subsidies in the form of tax rebates. But the United States, unwisely in our opinion, agreed in 1960 to exempt VAT taxes from this rule. Since that time, most countries have moved to a VAT system and, in fact, the United States is the only major trading country today not to employ a VAT.

While this is something of a stealth issue, the impact is enormous. According to calculations done by the American Manufacturing Trade Action Coalition[2], the VAT inequity cost U.S. producers and service providers $341 billion in additional taxes on U.S. exports. These are extra taxes that U.S. exporters pay to do business overseas that their competition does not have to pay. That means an awfully lot of lost business for U.S. manufacturers and is a significant barrier for small- and medium-sized business who want to export their products.

[1] Most developing countries put high duties on U.S. exports of manufactured goods, usually 15 percent or more. In the case of textiles, duties are usually much higher, starting at 20 percent and, in the case of India, reaching as high as 400 percent (on woven shirts). The Doha Development Round of World Trade Organization talks has ground to a halt on the issue of developing countries being willing to open their markets to manufacturing exports. Currently, India, China and Brazil are refusing to support anything more than token cuts to their actual duty rates and, additionally, are asking for the ability to shield entire sectors, including textiles, from making any duty cuts. At present, U.S. exporters stand little hope of gaining any real market access from these talks.

[2] See www.amtacdc.org; also see www.bordertaxinequity.net for a thorough review of the VAT problem and how to solve it.

NCTO believes the VAT disadvantage is one of the major reasons that U.S. exporters are not doing better overseas and that U.S. producers are facing such tough competition from China and others in the U.S. market. In fact, it cannot be otherwise – a 15 percent margin is simply too big an obstacle to overcome for many U.S. manufacturers. Profit margins in U.S. manufacturing average less than six percent and in the textile industry they typically range from two to three percent. Giving your competitor a 15 percent price break because they are bringing goods in from offshore is usually tantamount to giving the sale away.

It may not be surprising that the biggest winners from the VAT problem also run the largest trade deficits with the United States:

VAT Disadvantage Leads to Large Trade Deficits ($ bil.)		
	VAT Disadvantage	U.S. Trade Deficit
China	$48	$201
Mexico	$41	$120
Canada	$33	$78
Germany	$18	$51
Source: OECD, U.S. Census, 2005.		

Finally, another significant problem with the VAT is that it provides a convenient loophole for countries to negate duty concessions made as part of a bilateral, regional or multilateral trade agreement. For instance, declines in applied tariff rates in the European Union have been mirrored by increases in standard VAT rates. This has led to a situation where total charges to imports from a country like the United States are almost identical to what they were forty years ago despite declining tariffs.

There is a short term answer to the VAT disadvantage. It is the Border Tax Equity Act, H.R. 2600 introduced by Congressmen Bill Pascrell (D-NJ) and Mike Michaud (D-ME), a member of this committee, as well as Congressmen Duncan Hunter (R-CA), and Walter Jones (R-NC). The Act would negate the VAT disadvantage to U.S. producers and has three basic components. First, it would direct the United States Trade Representative (USTR) to negotiate a remedy for the VAT inequity through the WTO by 2009. Second, if there is no negotiated solution by that specified date, the United States then would begin charging an offsetting tax on goods and services at the U.S. border equal to the VAT rebated by the exporting country. Third, the U.S. government would rebate taxes to U.S. companies exporting goods to foreign countries at the same rate as those countries impose a VAT at their borders. NCTO strongly supports the Act and hopes the Committee members will review it with an eye towards correcting a fundamental inequity and spurring export growth among small and medium sized businesses in the United States.

CURRENCY MANIPULATION

The problem of currency manipulation has become better known as the trade deficit with China has grown to what must once have seemed unimaginable levels. The trade deficit with China has grown by 60 percent during the last three years and increased by 26 percent in April alone; it now stands at over $250 billion a year and consumes one third of the entire U.S. trade deficit.

China's manipulation of its currency is an export subsidy. Currency manipulation gives China's manufacturers a substantial unfair trade advantage, and the fact that U.S. manufacturing workers are the primary victims of China's policies is no longer disputed. President Bush, Alan

Greenspan, the International Monetary Fund and a long list of economists, politicians, think tanks and government institutions have all agreed that China should stop manipulating its currency and distorting world trade.

The swing side of the currency manipulation problem is that manipulation not only gives a huge bonus to imports from China but it also places a huge tax on exports from the United States. Just as U.S. imports from China get a price break of 25 to 40 percent from China's undervalued currency, U.S. companies trying to export to China are paying 25 to 40 percent more to sell their goods[3] in the Chinese market. This is a significant factor in the a trade balance where China exports five times as much to the U.S. as the U.S. exports to China.

What is less understood is that the Chinese model of suppressing its currency in order to build export markets is not an isolated case. China copied its Asian neighbors - Korea, Japan, Taiwan and others – when it began using its currency in the 1980s as an economic weapon to achieve higher living standards for its people. The export powerhouses in Asia have long practiced an economic mercantilist model for growth, one which depends on the development of export, rather than consumer, markets. The key strategies employed by these countries have been to develop national industrial strategies and marry them to undervalued currencies in order to dominate manufacturers in their home markets in the United States and Europe.

The problem is therefore not just with China but with economies across Asia that manage their currencies. And the answer to the problem is one step away from resolution – H.R. 2942, the Currency Reform for Fair Trade Act of 2007 sponsored by Congressmen Tim Ryan (D-OH) and Duncan Hunter (R-CA). This bill, which has been strongly supported by members of this committee, [4] would give U.S. manufacturers the tools to combat currency manipulation by China and others. This tool is simply the legal ability for injured U.S. manufacturers to seek countervailing duties based on the damage that currency manipulation has caused their companies. The enactment of the Ryan-Hunter bill would send the most powerful message possible that the U.S. Congress will not allow China in particular to continue to wreak havoc in the U.S. manufacturing sector and that Congress intends to begin to redress the 1.5 million manufacturing jobs that have been lost to China over the last ten years[5].

GOVERNMENT SUBSIDIES

The third major government barrier that U.S. exports face is the presence of government subsidies to domestic producers. These subsidies, which in the case of China, Vietnam and India, are significant in size and scope, make it extremely difficult for U.S. exporters to compete in these foreign markets. And these are, unfortunately, precisely the markets where the greatest economic growth is occurring today. By using subsidies to support domestic producers, these countries are essentially walling off a large portion of their economies from U.S. exporters.

China is of course the iconic model for how to subsidize an industry, indeed an entire economy, into a world export powerhouse. As a non-market economy, China has decades of experience in using central government command and control policies to shape industrial growth. In textiles, to cite one example, China has now embarked on its ELEVENTH Five Year Plan for the textile sector.

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[3] Regarding the amount of undervaluation of the Chinese yuan, the most widely used figure is 40 percent. Since China began increasing the value of the yuan in 2006, the yuan has appreciated by 19 percent, though in nominal trade-weighted terms, which are more accurate, the appreciation is only 12 percent.

[4] This bill superseded the Fair Currency Act of 2007, HR 782. Fourteen members of the HSBC co-sponsored either one or both of these acts.

[5] http://www.uscc.gov/researchpapers/comm_research_archive.php, U.S.-China Economic and Security Review Commission, Feb 2005.

It was not until recently that we were able to get a more comprehensive picture of precisely how China directs and supports its manufacturing sector. This picture has been unfolding steadily since the U.S. government overturned existing policy late in 2006 and began allowing U.S. industry to file countervailing duty cases against China.

The picture that has emerged is deeply troubling. China's government subsidies are now known to be available in every area that impacts the cost of a manufactured good -- from the cost of labor to the cost of capitol, from the cost of electricity to the cost of land, from the cost of new machinery to the cost of advertising and promotion. CVD cases brought by U.S. industry have identified dozens of subsidies that the Chinese government offers companies that export goods to the United States.

As an example, in a textile products case involving laminated woven sacks, the U.S. government found that the Chinese government offered 24 different subsidies to its domestic producers. As a result, the government imposed countervailing duties ranging from 27 to 359 percent on Chinese exporters of these products.

The U.S. government's decision to allow CVD cases to be filed against non-market economies like China was an important step in addressing the problem of China's government intervention in its economy. But it is only a first step. It is only a first step because it does not prevent China from subsidizing its manufacturers; it only deters those few producers whose specific products have countervailing duty imposed against them. For most small and medium sized manufacturers, CVD cases are simply too expensive and time consuming to file. The cost to simply prepare a case for filing typically runs over one million dollars.

What the government needs to do is to go after China in the World Trade Organization both where China's subsidies are de facto illegal but also in cases where China's subsidies can be ruled as illegal because of the damage they cause to U.S. industry.   The U.S. government has stepped up its prosecution of some de facto illegal subsidies over the past several years but still has not allocated the resources to make this a major initiative. For example, over one year ago, NCTO sent the Office of the United States Trade Representative (USTR) a list of 63 subsidies (attached) that China offers its domestic textile industry and requested USTR to investigate whether the subsidies were de facto illegal. We are still waiting for an answer. The problem, we have been told, is resource allocation. It is still unfortunately the case at USTR and elsewhere that significantly more resources are devoted to negotiating new trade agreements than in enforcing existing ones.

On this front, Congress can also play a significant role.   Congress should change USTR's focus for the next five years from negotiating new agreements to reviewing and enforcing existing agreements. USTR's resources should be re-oriented towards verifying that China and others are living up to the agreements that they have signed and, if they are not, they should file cases against them at the WTO.

CONCLUSION

The United States exported almost $1.2 trillion dollars last year, an impressive level of exports by any standard. Most of those exports went to Europe, Canada and Mexico while exports to China, India, Brazil and other rapidly growing markets remain far behind. And the U.S. manufacturing sector, not so long ago the world's greatest exporter, has now been displaced by China which continues to grow at double digit rates.

The principal reasons are a trifecta of barriers to U.S. exporters that have been erected by these rapidly growing and developing economies. These include the VAT, currency manipulation and subsidy regimes. As outlined in this testimony, Congress today has legislation in hand that can begin to roll back these barriers and usher in a new renaissance for the U.S. manufacturing sector and its workers. We thank the Committee for its continuing efforts to highlight the importance of the U.S. manufacturing sector and for holding a hearing on this important subject.